

KARSCH CAPITAL II, LP
(a limited partnership)

FINANCIAL STATEMENTS

DECEMBER 31, 2005

KARSCH CAPITAL II, LP
(a limited partnership)

CONTENTS
December 31, 2005

Independent Auditor's Report	1
Financial Statements:	
Statement of Financial Condition	2
Condensed Schedule of Investments	3 - 7
Statement of Income	8
Statement of Changes in Partners' Capital	9
Statement of Cash Flows	10
Notes to Financial Statements	11 - 13



GOLDSTEIN GOLUB KESSLER LLP

Certified Public Accountants and Consultants

INDEPENDENT AUDITOR'S REPORT

To the Partners of
Karsch Capital II, LP

We have audited the accompanying statement of financial condition of Karsch Capital II, LP (a limited partnership), including the condensed schedule of investments, as of December 31, 2005, and the related statements of income, changes in Partners' capital, and cash flows for the year then ended. These financial statements are the responsibility of the General Partner. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Karsch Capital II, LP as of December 31, 2005 and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Goldstein Golub Kessler LLP

GOLDSTEIN GOLUB KESSLER LLP

March 10, 2006

KARSCH CAPITAL II, LP
(a limited partnership)

STATEMENT OF FINANCIAL CONDITION

December 31, 2005

ASSETS

Investments in Securities, at fair value (cost \$383,305,954)	\$433,508,936
Due from Brokers	195,230,753
Interest and Dividends Receivable	659,926
Cash	35,186
Total Assets	\$629,434,801

LIABILITIES AND PARTNERS' CAPITAL

Liabilities:	
Securities sold short, at fair value (proceeds \$213,197,070)	\$206,220,420
Due to Partners	21,518,642
Contributions received in advance	7,000,000
Accrued expenses and other liabilities	657,891
Total liabilities	235,396,953
Partners' Capital	394,037,848
Total Liabilities and Partners' Capital	\$629,434,801

See Notes to Financial Statements

KARSCH CAPITAL II, LP
(a limited partnership)

CONDENSED SCHEDULE OF INVESTMENTS

December 31, 2005

Number of Shares	Description		Fair Value
	Common Stocks - United States	85.99%	
	Advertising	1.04%	\$ 4,106,493
	Communications	3.88%	15,297,978
	Consumer Products	16.74%	65,981,151
	Consumer Services	2.42%	9,544,907
	Entertainment	.22%	849,807
	Financial	12.65%	49,829,784
	Healthcare		
412,050	Omnicare Inc.	5.98%	23,577,501
	Other	3.17%	12,504,938
	Lodging	.12%	464,167
	Manufacturing	2.58%	10,155,697
	Restaurants	1.49%	5,885,152
	Retail		
563,710	Loews Corporation	6.29%	24,797,603
	Other	7.14%	28,123,937
	Semiconductors	4.54%	17,895,185
	Software	6.34%	24,966,894
	Transportation	3.13%	12,326,070
	Utilities		
1,057,390	Williams Companies Inc.	6.22%	24,499,726
	Other	2.04%	8,019,575
	Total United States common stocks (cost \$297,247,499)		338,826,565
	Common Stocks - Foreign		
	France	7.80%	
	Construction Services		
357,650	Vinci GTM	7.80%	30,746,006
	Total France common stocks (cost \$30,221,819)		30,746,006

Percentages shown represent percent of Partners' capital.

(continued)

See Notes to Financial Statements

KARSCH CAPITAL II, LP
(a limited partnership)

CONDENSED SCHEDULE OF INVESTMENTS

December 31, 2005

Number of Shares	Description	Fair Value
	Germany 7.92%	
304,790	Financial Deutsche Boerse AG 7.92%	\$ 31,218,557
	Total Germany common stocks (cost \$23,707,518)	31,218,557
	Hong Kong 1.34%	
	Financial 1.34%	5,289,473
	Total Hong Kong common stocks (cost \$4,941,788)	5,289,473
	Netherlands .43%	
	Financial .43%	1,689,042
	Total Netherlands common stocks (cost \$1,680,291)	1,689,042
	Sweden 1.02%	
	Software 1.02%	4,030,643
	Total Sweden common stocks (cost \$3,714,567)	4,030,643
	Switzerland 5.32%	
220,500	Financial UBS AG 5.32%	20,975,249
	Total Switzerland common stocks (cost \$20,440,688)	20,975,249
	Total foreign common stocks (cost \$84,706,671)	93,948,970
	Total common stocks (cost \$381,954,170)	432,775,535
	Bonds - United States .03%	
	Communications .03%	123,760
	Total United States bonds (cost \$199,453)	123,760

Percentages shown represent percent of Partners' capital.

(continued)

See Notes to Financial Statements

KARSCH CAPITAL II, LP
(a limited partnership)

CONDENSED SCHEDULE OF INVESTMENTS

December 31, 2005

Number of Shares	Description	Fair Value
	Put and Call Options Purchased	.15%
	Financial	.10% \$ 410,231
	Healthcare	.02% 69,360
	Retail	.03% 130,050
Total put and call options purchased (cost \$1,152,331)		609,641
Total investments in securities (cost \$383,305,954)		\$433,508,936

Percentages shown represent percent of Partners' capital.

(continued)

See Notes to Financial Statements

KARSCH CAPITAL II, LP
(a limited partnership)

CONDENSED SCHEDULE OF INVESTMENTS

December 31, 2005

Number of Shares	Description		Fair Value
Securities Sold Short			
	Common Stocks Sold Short - United States	47.66%	
	Automobiles		
1,075,280	General Motors Corporation	5.30%	\$ 20,881,938
	Other	5.90%	23,266,150
	Communications	1.09%	4,312,261
	Construction Services	1.63%	6,420,045
	Consumer Products	9.34%	36,820,486
	Education	1.53%	6,025,188
	Financial		
487,940	Streettracks Index Shares Mutual Fund	5.25%	20,678,897
	Other	13.12%	51,694,898
	Lodging	.67%	2,636,201
	Machinery	1.34%	5,261,262
	Restaurants	.32%	1,259,618
	Retail	.68%	2,674,568
	Semiconductors	.64%	2,513,883
	Utilities	.85%	3,331,319
	Total United States common stocks sold short (proceeds \$195,120,714)		187,776,714
	Common Stocks Sold Short - Foreign		
	Canada	1.32%	
	Pharmaceuticals	1.32%	5,220,645
	Total Canada common stocks sold short (proceeds \$4,750,628)		5,220,645
	Total foreign common stocks sold short (proceeds \$4,750,628)		5,220,645
	Total common stocks sold short (proceeds \$199,871,342)		192,997,359

Percentages shown represent percent of Partners' capital.

(continued)

See Notes to Financial Statements

KARSCH CAPITAL II, LP
(a limited partnership)

CONDENSED SCHEDULE OF INVESTMENTS

December 31, 2005

Number of Shares	Description	Fair Value
	Bonds Sold Short - United States .03%	
	Communications .03%	\$ 129,360
	Total United States bonds sold short (proceeds \$200,970)	129,360
	Bonds Sold Short - Foreign	
	Great Britain 3.08%	
	Financial 3.08%	12,144,386
	Total foreign bonds sold short (proceeds \$12,064,797)	12,144,386
	Total bonds sold short (proceeds \$12,265,767)	12,273,746
	Put and Call Options Written .24%	
5,885	Automobile General Motors Corporation .21%	829,315
	Financial .03%	120,000
	Total put and call options written (proceeds \$1,059,961)	949,315
	Total securities sold short (proceeds \$213,197,070)	\$206,220,420

Percentages shown represent percent of Partners' capital.

See Notes to Financial Statements

KARSCH CAPITAL II, LP
(a limited partnership)

STATEMENT OF INCOME

Year ended December 31, 2005

Investment income:	
Income:	
Interest	\$ 5,203,915
Dividends	4,932,884
Total income	10,136,799
Expenses:	
Management fee	4,823,524
Dividends	3,193,114
Professional fees	79,221
Interest	807,453
Other	60,808
Total expenses	8,964,120
Net investment income	1,172,679
Realized and unrealized gain on investments:	
Net realized gain on investments	39,472,897
Change in unrealized appreciation of investments for the year	7,322,878
Net realized and unrealized gain on investments	46,795,775
Net income	\$47,968,454

See Notes to Financial Statements

KARSCH CAPITAL II, LP
(a limited partnership)

STATEMENT OF CHANGES IN PARTNERS' CAPITAL

Year ended December 31, 2005

Partners' capital at December 31, 2004	\$356,174,730
Contributions	80,551,492
Withdrawals	(90,656,828)
Allocation of net income:	
Special allocation to General Partner	9,222,344
Allocation to all Partners	38,746,110
Partners' capital at December 31, 2005	\$394,037,848

See Notes to Financial Statements

KARSCH CAPITAL II, LP
(a limited partnership)

STATEMENT OF CASH FLOWS

Year ended December 31, 2005

Cash flows from operating activities:	
Net income	\$ 47,968,454
Adjustments to reconcile net income to net cash provided by operating activities:	
Changes in operating assets and liabilities:	
Increase in investments in securities, at fair value	(39,120,097)
Decrease in due from brokers	68,285,656
Increase in interest and dividends receivable	(253,551)
Decrease in other assets	5,872
Increase in securities sold short, at fair value	2,190,527
Increase in accrued expenses and other liabilities	342,757
Net cash provided by operating activities	79,419,618
Cash flows from financing activities:	
Partners' capital contributions	36,553,004
Partners' capital withdrawals	(115,944,040)
Net cash used in financing activities	(79,391,036)
Net increase in cash	28,582
Cash at beginning of year	6,604
Cash at end of year	\$ 35,186
Supplemental disclosure of cash flow information:	
Cash paid during the year for interest	\$ 653,092
Non-cash financing activity:	
Partners' Contribution of securities, at fair value	\$ 5,448,488

See Notes to Financial Statements

KARSCH CAPITAL II, LP
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NOTES TO FINANCIAL STATEMENTS
December 31, 2005

**1. ORGANIZATION
AND SIGNIFICANT
ACCOUNTING
POLICIES:**

Karsch Capital II, LP (the "Partnership") was formed in September 2000 pursuant to the laws of the State of Delaware to invest and trade in securities. The General Partner of the Partnership is Karsch Associates, LLC (the "General Partner").

These financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America which may require the use of estimates by the General Partner.

Investments in securities traded on a national securities exchange or listed on the Nasdaq National Market ("Nasdaq") are valued at the last reported sales price on the primary exchange on which such securities have traded on the last business day of the year. Investments in securities traded in the over-the-counter market and not listed on Nasdaq are valued at the last reported bid price if held long, or ask price if sold short. Options listed on a national securities exchange or Nasdaq will be valued at the mean between their bid and ask prices.

Purchases and sales of securities are recorded on a trade-date basis. Realized gains and losses are recognized based on the specific-identification method. Dividend income and dividends on securities sold short are recorded on the ex-dividend date.

No provision is made in the accompanying financial statements for federal, state and local income taxes since such liabilities are the responsibility of the individual Partners.

Assets and liabilities denominated in foreign currencies are translated at year-end rates of exchange with the resulting gains and losses reflected in income. Purchases and sales of securities and income and expense items denominated in foreign currencies are translated on the respective dates of such transactions.

The industry classifications included in the condensed schedule of investments represent the General Partner's belief as to the most meaningful presentation of the classification of the Partnership's investments.

**2. DUE FROM
BROKERS/
SECURITIES HELD
AT BROKERS:**

The clearing and depository operations for the Partnership's security transactions are provided by three brokers, one of which, Goldman Sachs & Co., serves as the Partnership's primary broker, in which capacity it is custodian of substantially all the Partnership's security positions and cash. For financial reporting purposes, amounts due to brokers have been offset against amounts due from these brokers for securities sold short, and other items. At December 31, 2005, substantially all of the securities owned and amounts due from brokers reflected in the statement of financial condition are positions with and amounts due from this broker. The brokers' right to sell or pledge this collateral is limited to 140% of the amount due to the brokers, after adjusting for securities sold short. Subsequent market fluctuations may require purchasing the securities sold short at prices that differ from the market value reflected in the statement of financial condition.

Investments in securities and securities sold short are subject to margin requirements.

KARSCH CAPITAL II, LP
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NOTES TO FINANCIAL STATEMENTS
December 31, 2005

**3. DERIVATIVE
FINANCIAL
INSTRUMENTS:**

The Partnership's activities include the purchase and sale of a variety of derivative financial instruments such as equity options, forward currency contracts and swap agreements. These derivatives are used for trading purposes and for managing risk associated with the portfolio of investments. All positions are reported in the accompanying statement of financial condition at either fair value or open-trade equity and any change in fair value is reflected in the accompanying statement of income as gain or loss as it occurs.

**4. RELATED PARTY
TRANSACTIONS:**

Karsch Capital Management, LP ("KCM"), a related entity, provides administrative services to the Partnership. In consideration, KCM receives a management fee in the amount of .25% per quarter. Limited Partners contributing capital effective March 1, 2004 are charged .375% per quarter. The fee is paid quarterly in advance and is based on the value of each Limited Partner's capital account as of the beginning of the quarter. The management fee for the year ended December 31, 2005 is \$4,823,524.

The Partnership agreement provides for the reallocation to the General Partner of 20% of the net income that is allocable to the capital accounts of the Limited Partners.

**5. FINANCIAL
HIGHLIGHTS:**

The information presented below represents the financial highlights applicable to the Limited Partner class of the Partnership taken as a whole (the nonmanaging Partners).

Operating Performance:

Total return before incentive allocation	12.94 %
Incentive allocation	<u>(2.58) %</u>
Total return after incentive allocation	<u>10.36 %</u>

Total return is calculated for the Limited Partner class taken as a whole. An individual investor's return may vary from these returns based on participation in New Issues, different management fee arrangements and the timing of capital contributions and withdrawals.

Supplemental Data:

Ratio to Limited Partner average net assets (Limited Partners' capital):

Operating expenses (including short dividends)	2.34 %
Incentive allocation	<u>2.45 %</u>
Total expenses and incentive allocation	<u>4.79 %</u>
Net investment income	<u>.74 %</u>

KARSCH CAPITAL II, LP
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NOTES TO FINANCIAL STATEMENTS
December 31, 2005

The ratios shown above are calculated for the Limited Partner class taken as a whole. The ratio for an individual investor may vary from these ratios based on different management fee arrangements and the timing of capital contributions and withdrawals.

**6. SUBSEQUENT
EVENTS:**

Subsequent to December 31, 2005, Limited Partners contributed \$40,419,250, of which \$7,000,000 was received in advance.